

VZCZCXRO8932  
RR RUEHCN RUEHGH  
DE RUEHGH #0105/01 0631028  
ZNR UUUUU ZZH  
R 041028Z MAR 09  
FM AMCONSUL SHANGHAI  
TO RUEHC/SECSTATE WASHDC 7698  
INFO RUEHBJ/AMEMBASSY BEIJING 2572  
RUEHCN/AMCONSUL CHENGDU 1794  
RUEHGH/AMCONSUL GUANGZHOU 0250  
RUEHHK/AMCONSUL HONG KONG 1961  
RUEHUL/AMEMBASSY SEOUL 0392  
RUEHGH/AMCONSUL SHANGHAI 8332  
RUEHSH/AMCONSUL SHENYANG 1785  
RUEHIN/AIT TAIPEI 1582  
RUEHKO/AMEMBASSY TOKYO 0567  
RUCPDO/DEPT OF COMMERCE WASHINGTON DC  
RUEATRS/DEPT OF TREASURY WASHINGTON DC

UNCLAS SECTION 01 OF 04 SHANGHAI 000105

SENSITIVE  
SIPDIS

STATE FOR EAP/CM, DAS DAVIES  
TREASURY FOR OASIA/INA -- DOHNER/HAARSAGER/WINSHIP  
TREASURY FOR IMFP -- SOBEL/CUSHMAN  
USDOC FOR ITA DAS KASOFF, MELCHER, MAC/OCEA  
NSC FOR LOI  
STATE PASS CEA FOR BLOCK  
STATE PASS USTR FOR STRATFORD/WINTER/MCCARTIN/KATZ/MAIN  
STATE PASS CFTC FOR OIA/GORLICK

E.O. 12958: N/A

TAGS: [CH](#) [ECON](#) [EFIN](#) [PGOV](#)

SUBJECT: (SBU) YANGTZE RIVER DELTA PROPERTY DEVELOPERS FEELING THE DOWNTURN

REF: A. A. Shanghai 078  
[1](#)B. B. 08 Shanghai 558

[1](#)1. (SBU) Summary. Prospective home buyers in the Yangtze River Delta are holding off on home purchases for now, preferring to wait on the sidelines in anticipation that home prices will continue to fall, according to a wide range of Consulate contacts Econoff spoke with in recent weeks. Banks, sensing developers' increasingly fragile finances, are becoming more cautious about lending to the real estate sector. Nonetheless, developers, buoyed by hopes that the market will quickly rebound, are loath to lower their prices, and instead are taking ad hoc cost-cutting measures. Ultimately, property developers assume that local governments will provide support for the sector if the crunch becomes too severe. End summary.

[1](#)2. (U) This is a third in a series of reports on the real estate market in East China.

=====  
Real Estate Demand Slumping Across the Yangtze River Delta  
=====

[1](#)3. (SBU) Prospective home buyers in the Yangtze River Delta are holding off on home purchases for now, preferring to wait on the sidelines in anticipation that home prices will continue to fall. Lin Fu, Chairman of the Board, Bank of Nanjing, said on January 21 that consumers have trained themselves to "make purchases when prices are rising, not when they are falling" (mai3zhang3 bu4mai3 diel). Real estate trading volume hit a low in October, according to the contacts, as confirmed by transaction data collected by Soufun and available through CEIC. Shanghai, for instance, peaked at above 3 million square meters of property sold in September 2007, but registered less than 1 million in October 2008; Hangzhou (downtown) peaked at almost 700,000 square meters in June 2007, and reached only 150,000 square meters in October 2008.

[1](#)4. (SBU) The shortfall in demand, in theory, should be leading to price declines that bring the market back into equilibrium.

However, developers, buoyed by hopes that the market will quickly rebound, are loath to lower their prices, according to our interlocutors. In addition, contacts say that developers are being warned by local governments not to cut selling prices, since this can lead to discontent among recent buyers who paid the higher price (ref. B). Therefore, indexes of nominal prices show only marginal housing price declines: Soufun.com's China Real Estate Index (ref. A) shows drops of only 1 to 3 percent in recent months for major cities in the Shanghai consular district.

=====

#### Falling Land Prices are Impacting Government Revenues

=====

15. (SBU) Land prices, on the other hand, have been impacted. For instance, Nanjing was planning to sell 9 million square meters of land in 2008, but in the end property developers bought 5 million, said Chen Xinghai, who is chairwoman of Xixia Construction Company, one of Nanjing's top three property developers, and who also leads the local property developers' association. According to figures from Centaline, one of China's leading mid-tier property agencies, the auction failure rate in 2008 reached 30 percent in Shanghai, 50 percent in Hangzhou, and 60 percent in Nanjing. (Note: The Nanjing figure varies from that provided by Xixia's Chen. End note.) For instance, land prices in Shanghai have fallen from over RMB3,000 per square meter at their peak in 2004, to under RMB2,000 per square meter in 2008, according to figures compiled by Centaline and DBS Vickers.

16. (SBU) The slow down in land sales--and to a lesser extent, the slowdown in transaction taxes on real estate--will lead to

SHANGHAI 00000105 002 OF 004

lower government revenues, our interlocutors said. Xixia's Chen said that Nanjing obtained off-budget revenues of RMB10 billion (approximately US\$ 1.5 billion) from land sales in 2008; the corporate banking chief of Bank of China, Jiangsu Branch, said this represents a fall 20 percent from the 2007 level. In addition, on-budget taxes from real estate amounted to 30 percent to 40 percent of Nanjing's fiscal income, said Chen. In Ningbo, much of local government income comes from land sales, claimed Soufun Ningbo General Manager You Yangbin and Ningbo Haipu Real Estate Agency General Manager Wang Xiaoyun.

=====

#### Real Estate Financing Sources are Getting Scarcer

=====

18. (SBU) Some property developers may start to experience liquidity problems as banks and other finance sources become less generous, while revenue inflows from purchases stall. Xixia's Chen said that banks are only willing to lend to the top 100 enterprises now, and since Xixia is the third-largest property developer in Nanjing, it faces fewer problems. An associate director of Prax Capital, a Shanghai-based private equity firm with a real estate fund, said that small developers seem to have fewer troubles, as they have less capital needs and can rely on local governments. However, said our interlocutor, medium-size developers may have greater difficulties funding themselves as the industry moves toward consolidation; among the large property developers, those who were not able to list before the stock market downturn now will be unable to raise equity, and therefore have the most fragile finances.

19. (SBU) A project director of Centaline Ningbo said that in the Ningbo market, local property developers work together to overcome liquidity problems. If one is short capital, the others will extend the needed financing. However, this network is not open to the national property developers that have entered the Ningbo market, said Zhang, such as Greentown. He laughed when recalling how these national operators were sometimes frozen out of the market, as when a company representative from nationally known Vanke once asked how a local property developer was selling many units in one building,

while buyers passed over Vanke's building next door.

¶10. (SBU) A Nanjing bank typifies the wariness that emerges in conversations with East China bankers about the real estate sector. Sheng Hong, Assistant Executive President, Nanjing Branch, China Everbright Bank, described how three years ago Everbright's head office in Beijing had instructed all branches that home mortgages were to be treated cautiously, with mortgage lending going forward only after approval from Beijing. Of particular concern, said Sheng, are "fake mortgages" (xuljia3 dai4kuan3) in which the property developer will get friends and relatives to take out mortgages on units in the developer's projects so the developer can use the revenue as operating capital, with the developer promising to repay the fake mortgages once sales to actual purchasers begins. In addition, Everbright has an internal rule that banks must move to foreclose on developers who have not sold completed apartments within four months.

=====  
Property Developers Affected by Land Bank, Corporate Structure  
=====

¶11. (SBU) A key variable for property developers' ability to wait out current market conditions is when they purchased the land they are building on. As Nanjing urban studies professor Zhang Hongyan explained, real estate prices may be lower than their peak, but they are still higher than the cost of land and materials, since housing costs have risen so rapidly in recent years, so property developers are not necessarily directly impacted. However, as the Centaline Ningbo's project manager

SHANGHAI 00000105 003 OF 004

explains, projects on land purchased in Ningbo in the early 2000's will remain profitable, but those built on land purchased when land prices peaked in 2007 will have difficulties. Ni Biao, real estate company office manager of Youngor, one of Ningbo's leading property developers, confirmed this, saying that a only a 10 percent drop in property prices would substantially impact projects on land purchased in the past three years, while projects on land purchased before that could absorb a 20 percent drop in property prices.

¶12. (SBU) A company like Youngor may face other difficulties raised by its corporate structure. Pressure to maintain companies' property sales prices, and therefore the profitability of the real estate unit, are higher as the slowing internal and external markets hits the companies' core apparel business, implied Youngor's Ni. Real estate typically makes up 40 percent of the profits for the Youngor Group, said Ni, but in 2008 Youngor met only around 70 percent of its sales targets.

=====  
Local Governments Assumed to Offer Bail Outs  
=====

¶13. (SBU) Contacts in the real estate industry were unanimous in assuming that the local governments would provide support for the sector if the crunch on property developers becomes too severe. "The authorities won't wait for the real estate industry to die," Xixia's Chen bluntly stated. Youngor's Ni said that the government would step in because of the industry's leading role in sustaining a variety of upstream and downstream sectors. Ni commented that Hangzhou in December 2008 already launched a "large-scale rescue" of the local real estate sector, since the property investment bubble and subsequent downturn were more severe there than in Ningbo.

¶14. (SBU) Governments could offer supports in a variety of ways, said our interlocutors. Banks will be encouraged to roll over loans, agreed Youngor's Ni and Zhan Rongsheng, a top researcher with the Ningbo Development and Reform Commission--Ni said that the government would want to forestall social instability that could originate in a real estate collapse. The Bank of China manager said that his bank already was anticipating rolling over much of the 30 percent of their

lending book that is in the real estate sector. The local government will also offer flexibility on the deadline by which property developers have to begin construction on land they have purchased, said Ni and Ningbo Centaline's project manager. Xixia's Chen cited the high-speed rail network planned to link Nanjing, Hangzhou, and Shanghai as potentially supporting commuters who wish to buy homes in Suzhou and work in Shanghai.

¶15. (SBU) Interlocutors stated that a drop of 30 percent overall in the real estate market would trigger a government bailout in a given locality. Yang Xiaoping, Director of the China Banking Regulatory Commission (CBRC), Zhejiang Office, told Econoff that since most buyers put 30 percent down on their mortgages, banks could sustain a drop in market value of that scale; Sheng Cheng, vice director of the China Real Estate Index System, based in Shanghai, independently suggested a similar scenario. However, the view was not unanimous: the Bank of China manager said that Nanjing performed a stress test this past fall at the behest of the CBRC head office, and that only two or three banks would be significantly impacted by a 30 percent fall in the local real estate market.

=====  
Property Developers Experimenting with Stop Gaps  
=====

¶16. (SBU) Property developers are taking other steps to increase sales or hoard cash during the downturn, said our contacts. Vanke, for instance, was willing in early in 2008 to

SHANGHAI 00000105 004 OF 004

begin cutting prices on unsold units in its developments, despite the wrath of previous customers (ref. B). Youngor's Ni said that the company may reduce prices by 10 percent. In addition, Vanke and Youngor--the latter having properties in relatively large second-tier cities such as Suzhou and Hangzhou, as well as third-tier cities such as Zhejiang's Taizhou and Shaoxing--are cutting the quality of fixtures and adding in extras such as garages or storage space to make price cuts less transparent, said Ningbo Centaline's project manager and Soufun Ningbo's You.

¶17. (SBU) Property developers are also delaying projects. Youngor is putting off 100,000 square meters of construction originally planned for 2009, amounting to one-third of its 2008 construction, said Ni. Xixia's Chen said that her company was dropping half of its planned construction this year, and that Vanke was decreasing its rate of units constructed by 30 percent.

=====  
Comment  
=====

¶18. (SBU) Property developers in East China are concerned Beijing is signaling that the real estate market should fall further to make housing more affordable. One example our interlocutors cite is the Chinese Academy of Social Sciences Blue Book on the China economy, released in December 2008, which said that real estate prices would continue to fall. A second is the rejection of the property sector as one of the ten sectors given national support plans by the State Council, a decision made final in the last week of February 2009. However, in East China these suggestions are falling on deaf ears. Property developers are generally confident they can gain the support of local governments should the downturn continue. Given the impact of the sector on local finances, the developers will have a solid opportunity to make their case.  
CAMP